DOW THEORY LETTERS INC.

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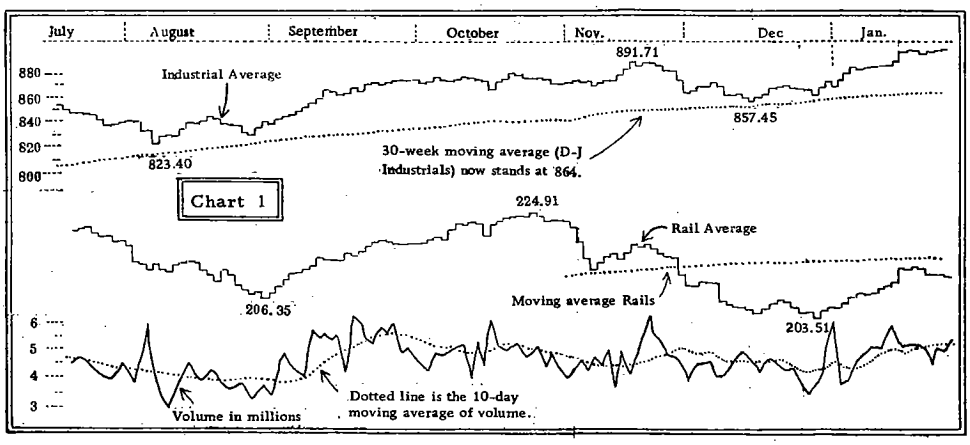
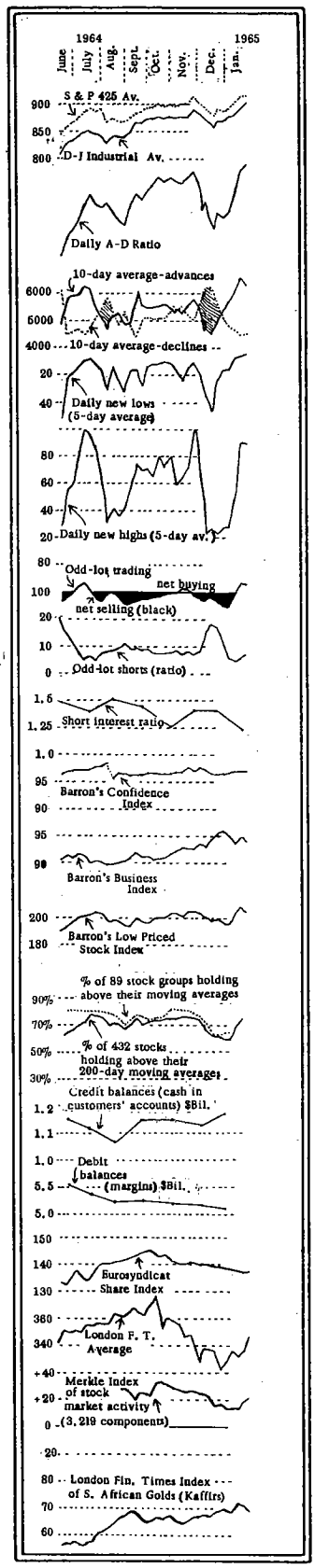
Exciting days on Wall Street: The writer was startled as this week's flood of market letters and advices were spread out on my desk and studied. Bullishness is nearly universal; almost all of those analysts who have recently been cautious or bearish are now predicting at least "a few more months" of strength, a small minority are talking about an important top to occur during the latter part of 1965, while still others believe that any slackening of the upward progress in 1965 will be a mere pause, a minor decline to be followed by new highs. But it is the "cave in" of caution which is so interesting, the withdrawal of bearishness, the rout of the skeptics. I might add, however, that one of the very few dissenting voices comes from Mr. Anthony Gaubis (20 Exchange Place, N.Y.C.), a veteran analyst who is used to going it alone. Among other things, Gaubis believes the odds are now in favor of: (1) An important business peak with a business downturn to start before the end of the second quarter. (2) A rapid, violent (and obviously unexpected) market decline lasting perhaps three to four months and erasing perhaps 20 to 28% of the value of the D-J Industrial Average. Gaubis believes that such a decline could start at any time. This writer does not attempt to predict important turning points (other than those signalled or indicated by Dow Theory), but I will state that Gaubis's market opinion is always highly professional and intelligent and is now particularly interesting from the standpoint of "contrary opinion." Bearish analysts willing to go on record as such are currently as scarce as the proverbial "hens' teeth," but it should be remembered that at important turns the majority of professionals are almost always wrong.

A few observations are worth making before going into strict technical analysis (an exercise which is a regular feature of these Letters and which appears under the heading of "The Market"). (1) The rise since June, 1962, is one of the longest primary advances in the record. Most such rises have been interrupted by extended reactions lasting up to six months or so. The sole exception was the 32 month rise which ended in March, 1937. The current advance is now in its 31st month. (2) In the past, stocks have been in a distribution zone when the average yield on the Industrial Averages dropped to the 3% zone or below. As a matter of fact, in almost all cases stocks turned down within a year after the average yield on the Industrial Average declined to the "3% level or below" (the single exception was the 15 month period prior to 1937). It has been 13 months since the Dow dropped under the 3% average yield area in December, 1963. (3) As seen on Chart 1, the Industrial Average is now only 4% above the high recorded late last July, while the Rail Average is actually below its July peak. The performance of the Averages since mid-1964 has been considerably less spectacular than the rise in bullish sentiment.

THE MARKET: The above paragraphs may be termed "personal observations," "opinions," or anything else you like. But the following is as cold-blooded an appraisal of the market as I can muster. "Why cold-blooded?" the new subscriber may ask. The answer is that Dow's Theory is based on the premise that the emotionless Averages themselves contain the sum total of everything known by anybody which can exert an effect on the market. "The movements of the Averages discount everything," wrote Robert Rhea, and I have seldom had occasion to doubt his words. It should also be stated that almost all the important movements in market history has been born amid conditions which were "predicted" or at least strongly





hinted at by the Averages — at a time when it was well nigh impossible (emotionally) to believe what the market was saying.

The majority of important turns or reversals on Wall Street have been preceded by a non-confirmation or a refusal of the two Averages to "agree." Thus, the last great turn in 1962 was foreshadowed when the two Averages broke to lows in June, rallied, then retreated in the face of the "Cuban crisis panic" of October. At the October lows Industrials stubbornly refused to confirm the new low recorded by the Rail Average. That striking non-confirmation marked the start of the 1962-64 rise.

Referring to the current situation, on July 17, 1964, Industrials rallied to a new bull market high of 851.35, Rails to a bull peak of 220.98. A correction carried into late August, following which the advance was resumed. Be late October (see Chart 1) Rails had climbed slightly above their July peak (to 224.91), while Industrials rallied to new historic highs. As far as Dow's Theory was concerned, the primary trend had been confirmed as bullish.

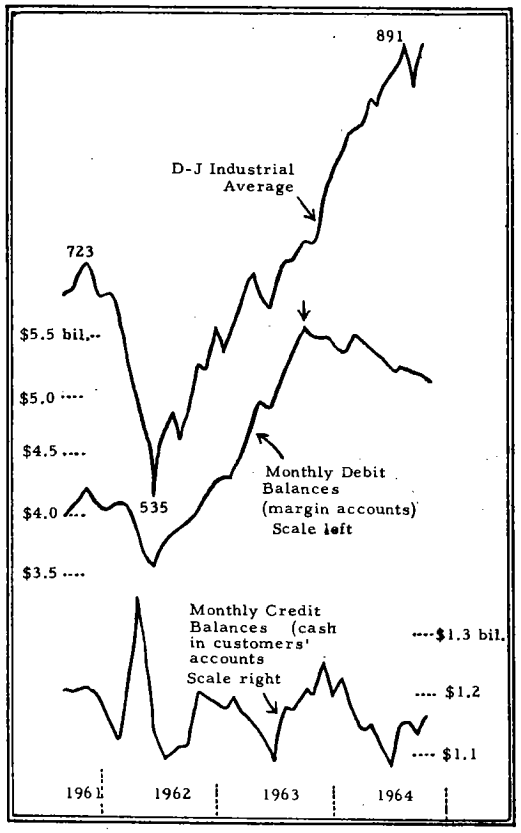
No sooner did Rails better their July high than they started down again. The steady downward progress of the carriers "upset" the Industrials, and be late November Industrials joined in the decline. On December 30, Rails broke to a new low (below their August low) of 203.51. Industrials, however, remained 35 points above their own August low and showed no inclination to confirm. The picture therefore remained bullish, and a new rally started.

The rally which began in December has carried into January of 1965, and we have seen the Industrial Average climb to successive new all-time highs. But what of the lagging Rail Average, what of the fact that the last Rail peak was recorded three months ago? During January Rails climbed approximately halfway back to their October high. By moving "in direction" with Industrials, the carriers have provided half-hearted technical support for the advance. Dow's Theory places no time limit on the confirmation principle; Rails may confirm in a week or a month. But as long as Rails fail to better their October high (224.91) they will not have given their vital half of a bull signal. Furthermore, the December lows (857.45 and 203.51) will continue to be the bear signal points as long as a Rail confirmation is not forthcoming. In this writer's opinion, it is now particularly important for the two Averages to move together on rallies. A persistent divergence (in this case, Rails declining while Industrials work higher) following the three-month failure of the Rail to confirm, could mean trouble ahead.

It is well to remember that Rail buyers and sellers represent a very professional segment of the stock market, and conversely, the public tend to be quite disinterested in rail equities. For this reason the writer never minimizes the predictive value of the Rail Average. (Note: with this issue I have added the 200-day moving average of the Rail Average, and this indicator should continue to be helpful in gauging the strength or weakness of the Rails).

Conclusion: The primary trend remains bullish; the secondary trend is obscure but may be considered bullish as long as Rails tend to move higher with Industrials. A Rail rise above 224.91 would reconfirm the primary bull trend.

The Composite Chart (Page 1) shows the two leading Industrial Averages at approximate all-time highs. The move has been confirmed by the A-D ratio. The 10-day average of daily advances and declines shows an "overbought" condition, but such conditions can last for weeks. New highs and lows are checking in bullishly. Odd-lotters have behaved about normally during the first part of January, they have reinvested with year-end extras and dividends. It is noticable, however, that odd-lot shorts are now very reluctant to enter the market. The short interest ratio for December was 1.22, about neutral. Barron's Confidence Index continues to move sideways. The percentage of stocks holding above their moving averages has risen to 80%, and this is a picture of strength. Debits and credits are discussed in detail later in the Letter. The S. African gold index has held remarkably well, and the "values" represented by the high-yielding Kaffirs have evidently been a much stronger prop under these issues than the "safe neighbor to the north" argument has been for the Canadian golds. For instance, Welkom (discussed in detail in Letter 276) has hardly budged during the whole gold sell-off. I continue to recommend Welkom, President Brand, Western Deep Levels, Blyvoors.



Conclusion: The majority of indicators continue to look bullish. Only the Rail Average, debit balances and perhaps Barron's Confidence Index even hint of the possibility that there may be a few evil guests at the Wall Street party.

TRAIL OF THE SPECULATOR: The debit balances on the N.Y.S.E. represent the total amount of cash borrowed against stocks. In the language of Wall Street, these are the margins. Sloan Wilson in his carefully documented book, The Speculator and the Stock Market, states that the professional speculator's greatest tool is his margin account. Furthermore, he shows that during all past bull markets, the speculator exits from the market before or sometimes just at the final top. In other words, the debit balances (or margin accounts) represent the trail of the professional speculators, the men who get out at or before the top.

A veteran Wall Streeter once told me: "Here's the way a bull trend develops.

First the professional and traders move in. They're the smartest segment in the market, the first to sense anything, the boy's who lay it on the line with their own hard cash. Then the funds and institutions come in. They're close to the pros, they don't like to lead, but when they see that the pros are right, they'll follow with big money. Finally, the crowd comes in. The public, the odd-lotters, they'll usually step in for the last third of the ride, and they'll usually stay in after the top and ride a bear market one to two-thirds of the way down. When a bull market tops out, it's the same thing. The pros are out first, then the funds and institutions, finally the public."

Historically, we know that the speculator always starts moving out at or before the final market top. Although we have no actual debit figures for 1929, we do have the brokers' loan figures (which would provide the same information), and these show that the loans turned down in September, 1929, simultaneously with the market. Brokers' loans never came back after 1929. The market had seen its top, and the speculators knew it.

In 1937 the debit balances touched their peak in March, again simultaneously with the Averages. But although Industrials struck a "double top" in August of that year, the debits remained in their declining trend. The professionals know that the 1937 party was over. Debits "topped" in June, 1945, a full eleven months before the final 1946 bull market top. This was one of the earliest of the "exits" provided by the speculators. In April, 1959, the debits turned down again, and this occurred eight months prior to the January, 1960, market top. Finally, debits hit a peak in December, 1962, simultaneously with the December peak in the Industrial Average.

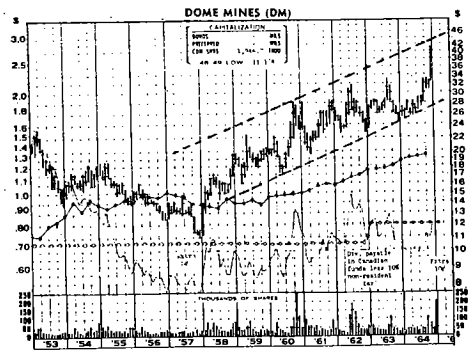
In the present situation (as seen on the chart, Page 2) debit balances turned down in November, 1963 — fourteen months ago! This was dramatized last week with the release of the latest debit figures for December, 1964. The December figures show a drop of $80 million in the debit account, taking it to its lowest level since August, 1963. This means that the speculator is continuing his steady liquidation of equities; it means that the smartest element in the market is continuing to move towards the exits.

But nothing is ever "pat" in the market. In the past when the professional was leaving (i.e., declining debit balances) the public was usually entering or "taking the bait." The entrance of the public could usually be detected by declining credit balances (i.e., cash left with brokerage houses). This duel relationship, however, has not appeared in the current market. Note on the chart that the public (which avoids margin and tends to buy for cash) has been indecisive during most of 1963 and 1964. For a short period between January and July, 1963, and again during April to September, 1964, it appeared that the public was reducing its cash balances and purchasing stocks. But over the past few months (despite continuously declining debit balances) the credit balances have pushed up again, indicating the continuing indecisiveness of the crowd.

After the 1962 crash both Sloan Wilson and I made the following observation: "History shows that it takes many years following a crash before the public gets up the nerve to enter the market wholeheartedly again." That statement has apparently held true for the post-1962 period. The public has never really come in "with both feet," and this is shown by the erratic (actually sideways) movement of the credit balances.

The situation described above underscores one of the most important arguments in the stock market today. For there is a certain school which insists that this bull market will not top out until the public finally comes in and buys heavily ("the mass entrance of the public will provide the long-awaited final 'blow-off'"). One of the leaders of this school is E. George Schaefer of Indianapolis. Another school believes that this bull market will top out simply because professionals do not like what they see ahead (monetary crisis, profit squeeze, political development, etc.). These analysts feel that the market is under subtle distribution already, and that we are now in the process of forming a top. Joseph Granville is a leading voice in this school.

This writer does not profess to know the answer. But I do feel that with a fourteen-month trend of declining debits, this bull market could end very suddenly — with little in the way of an "obvious" advanced warning. Every great bull market comes forth with a "fooler" at the end. Perhaps the fooler for this one will be a sudden termination with little or no orthodox warning indications. At any rate, it is well to remember that speculators have been unloading steadily since November, 1963, the month when the debit balances turned down.



STOCKS: Strongest groups are now publishing, drugs, vending. It may be significant that the Rail group is currently quite weak; I count 12 out of the 17 rail issues in the Traders Research chart books now showing bearish relative strength (RS) patterns.

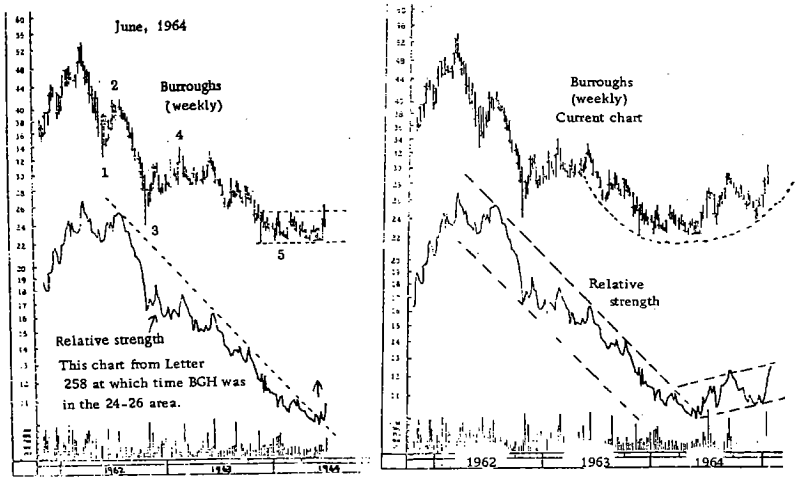
In the last Letter I advocated a position of perhaps 10% gold shares, 70% Treasury bills and the rest in stocks (if desired) for the ride to the final top. Gold stocks are the only hedge U. S. Citizens can assume against a possible devaluation. These issues should be treated as a hedge, and subscribers should remember that there is nothing else they can switch into or own which will provide a call against a possible rise in the price of gold. The Wall Street Journal (January 25, front page) headlined this story: "Johnson Budget Hints A Big Jump in Federal Spending Lies Ahead." The article further noted that we ".....may soon wave good-bye to Federal Budgets below $100 billion." If this is the case, gold will be called on to do more and more work. When DeGaulle asked for his $150 million in gold, he was testing the

strength of the dollar and the policies behind the dollar. As Alden Wells said in his most recent report (Alden Wells' Monetary Report, Palisades Park, N. J.): "Our response to the first overt French move was the weakest possible counter. We assured the world that we would continue our soft money policy, but that we would make more gold available." As long as this policy is persued, no one can write off the possibility of a monetary crisis.

Technically, the monthly chart of Dome Mines is of interest. Note that at its recent high of 41¼, DM practically touched the upper trendline of its long rising channel. Such action often calls for a correction. At its current price of 33-34 DM has corrected, dropping to about the middle of the channel. Note that in late 1960 DM also rose to the top of the channel, then dropped near the lower trendline before moving up again. It is my guess that this type of action (within the rising channel) will be typical of the Canadian golds until a possible rise in the price of gold metal takes place. If the price of gold is raised, I would expect to see all the golds surge above the upper trendline of the channels. Until then, these issues, as stated before, should be held on the premise that they constitute the only legal hedge against devaluation.

I continue to like the small group of stocks which have been discussed in these Letters over the past six months. These are the ones I would own, and these are the ones which many subscribers now hold in their speculative portfolios. Mohasco recommended at 12½ in Letter 248 has moved over 16 and continues to look strong. As this is written it has been announced that one of my speculative favorites, Schenley (recommended in Letter 269) has risen sharply due to management's announcement of their wish to purchase up to one million shares at 32. SH was recommended at 23. I now suggest selling half, riding with the rest. W. T. Grant recommended over and over is now acting spectacularly and is above 43. You sold half of your commitment (as per the last Letter) and are riding the rest. Amphenol Borg recommended in the last Letter is now over 26 and is still in a buying range. Crowell-Collier is creeping up and this one is also a good speculation, still in a buying range, with good upside potential.

A great many subscribers have been patiently holding Burroughs since it was first recommended here last June at 24. I believe it will be informative to review why I picked this issue, which has now appreciated by 33%. In Letter 257 I wrote: "BGH is now at approximately a 10-year low. The stock (once labeled a 'growth issue') pays a $1.00 dividend which affords a fair yield. BGH has held at the 22 level on five consecutive occasions since November; it has recently formed a rectangle after moving sideways through a long descending trendline. Its relative strength line also appears to be about to reverse to the upside. Risk in BGH — 3 points; it can be bought here and sold if it breaks 22."



In the next Letter (258) I again recommended BGH, and I then included a second analysis with the accompanying chart. Here attention was directed to the fact that BGH has undergone the 5-leg pattern which "is often associated with the completion of a major movement in a stock." I continued: "While such observations are, of course, strictly theoretical, it is possible that BGH has completed a major bear market of its own and is now ready to embark on a new bull phase. At worst, last week's breakout from point 5 suggests that a major (upward) correction in BGH is now underway. If such a correction succeeds in retracing only half the ground lost since the 1962 high, it could take BGH to 38."

What to do with BGH now? Note that on the second or current chart I have drawn in a large arc known as a "rounding bottom". This is one of the forms that upside reversals in higher grade stocks may assume. In bettering the 1964 high of 30, BGH has now provided a major reversal signal. On a point & figure basis (and this again is strictly theoretical), I see a base in BGH large enough to take the stock to the middle 40's. Hold it as long as the primary trend of the market remains bullish.

A real speculation, Gulf American Land, which was discussed last week continues to act all right. The accompanying point & figure chart shows an extended base for this issue, with a price objective (solid black square) of 13½. The stock is now selling around 6¼, and is churning up a lot of volume and interest on the Amex. If you want an interesting speculation which could be just about right for the "wind-up" of this bull market, I again direct your attention to GFD. The bear point on GFD is 4½; if it hits that level, the current upward trend will be reversed and there will be no further technical reason for holding the stock. "For those who think young."

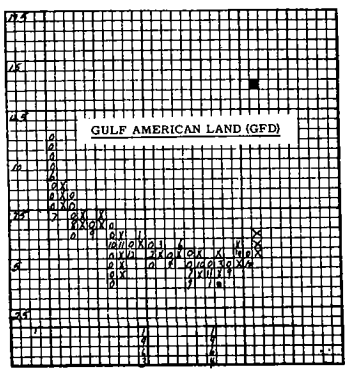


Chart of Dome courtesy of Security Research Corp., 211 Congress St., Boston, Mass.
Chart of BGH courtesy of Traders Research, 1431 Pearl Avenue, Alton, Illinois 62003
Chart of GFD courtesy of Chartcraft, Larchmont, New York.